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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1582

CONTRACTING PLUMBERS COOPERATIVE RESTORATION CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. App. A 1a-9a) is not officially reported. The opinion of the court of appeals (Pet. App. B 10a-18a) is reported at 488 F. 2d 684.

JURISDICTION

The judgment of the court of appeals (Pet. App. C 19a-20a) was entered on December 13, 1973, and a petition for rehearing was denied on January 23, 1974. The petition for a writ of certiorari was filed on April 22, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether petitioner, an organization of plumbers formed to arrange for the restoration of street excavations made by its members, is exempt from federal tax, either as an organization operated exclusively for the promotion of social welfare under Section 501(c)(4) of the Internal Revenue Code of 1954 or as a business league under Section 501(c)(6) of the Code.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Section 501(c) of the Internal Revenue Code of 1954 and Treasury Regulations, Sections 1.501(c)(4)-1 and 1.501(c)(6)-1, are set forth at Pet. App. D 21a-23a.

STATEMENT

Petitioner is a non-stock cooperative corporation organized under New York law for the purpose of coordinating the restoration of excavations made by New York City plumbers into city streets and sidewalks. Its membership is open, without charge, to all plumbers who are licensed by the City of New York (Pet. App. A 2a-3a).

Prior to petitioner's formation, the City of New York made all permanent repairs to streets and sidewalks opened by plumbers in connection with the installation and repair of plumbing facilities and billed the responsible plumber for the repairs at a set rate. Such permanent restoration generally took from eight to ten months to perform and resulted in annual operating losses to New York City of approximately $2 million (Pet. App. B 11a-12a). During the period that an excavation remained unrepaired, the plumber's agreement with the city required the plumber to indemnify it for any losses that it might sustain through actions brought by persons injured by the excavation (R. 42-43, 92, 159).[1]

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[1] "R." references are to the joint appendix filed in the court of appeals.

By 1967, the plumbers were so dissatisfied with the municipal restoration program that they threatened to sue the city unless it agreed to reduce substantially the period during which they remained liable for injuries caused by unrepaired streets and sidewalks (Pet. App. B 12a; R. 92, 160). The city, in turn, threatened to raise the repair rates it charged the plumbers for making the restorations in order to recoup the operating losses it had sustained in making the repairs (Pet. App. B 12a; R. 158). The controversy was ultimately resolved by the acceptance of the plumbers' proposal to conduct their own restoration program through a private, non-profit cooperative corporation. Accordingly, in 1968 petitioner was formed and began to coordinate the restoration program (Pet. App. B 12a).

Petitioner's certificate of incorporation and by-laws reflect that its primary purpose is to aid its membership in the restoration of streets and sidewalks damaged by their plumbing activities. Specifically, its certificate of incorporation provides that it "is created primarily for mutual help * * * for the purposes of assisting its members * * * by performing services connected with the purchase and acquisition for its members of labor, supplies and articles of common use" needed in the restoration program (R. 116). Its by-laws provide that the "purposes for which the Corporation is formed are to operate and maintain * * * a program * * * for rendering mutual help and service to the Corporation's members by arranging for the repaving or replacement of streets, curbs and sidewalks required to be repaved or replaced by the members of the Corporation * * *" (R. 123-124; Pet. App. B 14a).

A plumber who wishes to use petitioner's services in making a restoration indicates this fact to an appropriate city official when he obtains a permit to cut into the street or sidewalk. Upon completion of the plumbing

work, petitioner assigns the repair work to a private contractor and reimburses the contractor from funds collected in advance from the plumber. Through this procedure, petitioner has successfully maintained the same repair rates charged by the city prior to 1968, but has reduced the average restoration time to approximately 14 days (Pet. App. B 12a; R. 44-45, 47-50).

During 1968, petitioner realized taxable income of $5,239 from gross receipts of $433,762. Pursuant to petitioner's by-laws, this profit was distributed to various tax-exempt organizations which promote the plumbing industry in New York City (Pet. App. B 12a).

On audit, the Commissioner of Internal Revenue determined that petitioner owed federal income taxes on its income for 1968 because it was not exempt either as an organization operated exclusively for the promotion of social welfare under Section 501(c)(4) of the Code or as a business league under Section 501(c)(6). In a refund suit brought by petitioner, the district court held that it was exempt from federal income taxes under both Section 501(c)(4) and Section 501(c)(6) because of the significant benefits accruing to the residents of New York City through petitioner's restoration program (Pet. App. A 4a-9a.

The court of appeals reversed. It concluded that petitioner was not exempt as an organization operated exclusively for the promotion of social welfare because a substantial objective of both its organization and operation was to provide private economic benefits to its individual members, such as reduced restoration rates and lower liability exposure. The court further held that petitioner was not exempt as a business league, because it was engaged in the performance of particular services directed toward the general improvement of business conditions for the plumbing industry (Pet. App. B 10a-18a).

ARGUMENT

1. Section 501(c)(4) of the Code provides in pertinent part that "organizations not organized for profit but operated exclusively for the promotion of social welfare" are exempt from federal taxes. In defining the meaning of the term "exclusively" as used in a similar provision exempting an organization "operated exclusively for * * * educational purposes" from social security taxes, this Court stated in *Better Business Bureau* v. *United States*, 326 U.S. 279, 283, that "a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes." Relying on the "commercial hue" reflected in the organization's charter and its conduct of activities "largely animated by this commercial purpose," the Court held that the organization involved in *Better Business Bureau* was not tax-exempt, despite its "highly commendable" efforts to halt dishonest business practices and educate the business community. *Id.* at 283-284.

As a result, the courts have generally held that an organization cannot qualify for exemption under Section 501(c)(4) if any one of its substantial objectives is nonexempt in character. See *American Women Buyers Club, Inc.* v. *United States*, 338 F. 2d 526, 528 (C.A. 2); *People's Educational Camp Society, Inc.* v. *Commissioner*, 331 F. 2d 923, 931 (C.A. 2), certiorari denied, 379 U.S. 839; see also Treasury Regulations on Income Tax, Section 1.501(c)(4)-1(a)(2)(i). It is well established that the provision of economic benefits to an organization's individual members constitutes such a substantial nonexempt objective. *Commissioner* v. *Lake Forest, Inc.*, 305 F. 2d 814 (C.A. 4); *Consumer-Farmer Milk Coop.* v. *Commissioner*, 186 F. 2d 68 (C.A. 2), certiorari denied, 341 U.S. 931.

Here, the court of appeals correctly held that petitioner had a substantial objective which was incompatible with Section 501(c)(4) status, *i.e.*, to provide economic benefits to its members by maintaining low street repair rates and by reducing its members' exposure to accident liability. In support of its conclusion, the court pointed to four facts which demonstrate beyond question that petitioner's primary purpose was to provide economic benefits to its members. These are: (1) petitioner's formative history which indicated that it was organized because of the plumbers' disenchantment with prolonged liability for unrepaired excavations and because of the city's threats to increase repair costs; (2) the express purpose in the by-laws to operate for the mutual aid of its membership;[2] (3) the actual operation of petitioner which resulted in significant economic benefits to its member-plumbers through reduced liability exposure and maintenance of existing restoration fees; and (4) its members' enjoyment of economic benefits in direct proportion to their use of and payment for petitioner's repair services (Pet. App. B 13a-15a).

Petitioner challenges (Pet. 9) three[3] of the factors relied upon by the court of appeals. It first urges that there is no evidence that maintenance of restoration fees at their former level was a reason for the formation of petitioner. But in so arguing, it overlooks the undisputed evidence that the city was considering raising its fees in 1967 and that petitioner's organization prevented such increases (R. 45, 158; Pet. App. B 12a). Petitioner further

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[2]Petitioner's certificate of incorporation is to the same effect. See p. 3, *supra*.

[3]Petitioner does not dispute the fact that its by-laws show a substantial nonexempt objective, the second factor cited by the decision below.

denied that petitioner's members enjoyed substantial economic benefits in direct proportion to their use of its services by contending that the economic benefits which it provides its members in the form of lower liability exposure and lower costs is merely "part and parcel" of the benefits which it provides the public at large—reduced accidents and lower plumbing charges (Pet. 9-10). But the direct economic benefits enjoyed by petitioner's members were not merely incidental to public advantages derived from petitioner's activities; petitioner's services were provided to each member only to the extent that it paid for them and the services were never performed for nonmembers or nonplumbers (Pet. App. B 15a; R. 63, 80, 85). Thus, while there were collateral benefits accruing to the public from petitioner's operation (as is also true of many business operations), the existence of substantial private benefits to petitioner's members forecloses qualification under Section 501(c)(4), which requires an organization to operate "exclusively for the promotion of social welfare." As the court of appeals stated, "we find that the taxpayer provides substantial and different benefits to both the public and its private members, and that we therefore cannot say that it is 'primarily' devoted to the common good as required by even the most liberal reading of §501 (c)(4)" (Pet. App. B 16a).

2. Contrary to petitioner's contention (Pet. 7-10), the decision below does not conflict with *Monterey Public Parking Corp.* v. *United States*, 481 F. 2d 175 (C.A. 9). There, several private business and professional persons organized a corporation for the purpose of constructing and operating a public off-street parking facility in a downtown area. The court found that all persons using the parking facility paid the same rates, whether they shopped at member businesses or not; that no special privileges, such as advertising rights, were given the members;

and that the parking facility was designed to serve all city residents and businesses. The court concluded that "a quantitative comparison of the private versus the public benefits derived from the organization" demonstrated that the organization did not provide substantial private benefits in any way. *Id.* at 177. Here, however, petitioner's services were limited to members, and, as the court of appeals correctly noted (Pet. App. B 16a), the benefits flowing to petitioner's members were different in character from the benefits which inured to nonmembers and the public.[4]

3. The decision below further held that petitioner was not entitled to tax-exempt status under Section 501(c)(6), as a "business league" "not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual." In order to qualify for exemption under this provision, Section 1.501 (c)(6)-1 of the Treasury Regulations requires that the organization's activities be directed to the "improvement of business conditions of one or more lines of business as distinguished from the performance of particular

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[4]Nothing in Rev. Rul. 72-102, 1972-1 Cum. Bull. 149, as modified by Rev. Rul. 74-99, 1974-9 Int. Rev. Bull. 11, cited by petitioner (Pet. 11), casts doubt upon the correctness of the decision below. The ruling as modified held that an organization composed of members of a housing development formed to preserve its appearance and to maintain streets and common areas was entitled to Section 501(c)(4) status where: (1) the development was large enough to constitute a small community; (2) the organization owned only property open to members of the public, such as roadways, parklands and sidewalks; and (3) the benefits to the members and to the developer who originally established the organization were merely inidental in character. On these facts, wholly distinguisable from the situation here, the ruling concluded that the private benefits accruing to the developer and the members were incidental to the public goal to which the organization's activities were directed, the common good of the community.

services for individual persons."[5] Thus, the critical distinction for purposes of Section 501(c)(6) is whether the business league benefits the business or industry generally, regardless of individual payments or fees, in which case it qualifies for tax exemption, or whether it merely sells services to individual members for a fee, in which case it is not tax exempt. See, *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 1001 (Ct. Cl.); *United States* v. *Oklahoma City Retailers Assn.*, 331 F. 2d 328, 331 (C.A. 10); *Evanston-North Shore Board of Realtors* v. *United States*, 320 F. 2d 375, 379 (Ct. Cl.), certiorari denied, 376 U.S. 931; *General Contractors' Assn.* v. *United States*, 202 F. 2d 633, 636 (C.A. 7); Rev. Rul. 74-308, 1974-26 Int. Rev. Bull. 12.

Applying this established legal criterion, the court of appeals correctly held that petitioner is primarily engaged in rendering services for its individual members. Each of petitioner's members makes payments to petitioner in exact proportion to the benefits he receives; no payments are made except to the extent that a member requires petitioner's restoration services to repair an excavation caused by his plumbing activities. Petitioner performs no function for the plumbing industry. Rather, it simply coordinates the repair of streets and sidewalks which its member-plumbers have excavated. Even though its activities may indirectly benefit the plumbing trade, its direct benefits are only to those plumbers who pay for petitioner's services—a commercial function which cannot be reconciled with Section 501(c)(6) status.

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[5] This regulation, whose predecessor (Treasury Regulations 74 (1929 ed.), Art. 528) was first adopted in 1929, has repeatedly been held to be a valid interpretation of the statutory language having the force of law. See *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 999 (Ct. Cl.).

Petitioner does not challenge the test applied by the court of appeals in comparing the benefits it provides to its members with the benefits to the plumbing industry generally. It does, however, attack the conclusion of the court of appeals that the benefits to individual members predominated over the benefits to the industry as a whole. But the precise *quid pro quo* character of the members' payments and petitioner's services in itself shows that the importance of the benefits to the members far outweighed any generalized advantage to the industry as a whole.[6]

Finally, petitioner argues (Pet. 15-16) that the decision below is in conflict with *Crooks* v. *Kansas City Hay Dealers Assn.*, 37 F. 2d 83 (C.A. 8), affirming 28 F. 2d 909 (W.D. Mo.). In that case, the court held that an association of hay merchants, which performed weighing and other services for its members, was an exempt "business league" under Section 231 of the Revenue Act of 1924, 43 Stat. 282, a predecessor provision of Section 501(c)(6). While the facts are closely analogous to those involved here, the decision was rendered prior to the promulgation of the present version of the Treasury Regulations under Section 501(c)(6), which provide (Section 1.501 (c)(6)-1) that the organization's "activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the per-

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[6]Petitioner contends that it did not perform any services for its members on the ground that it only took over the furnishing of services formerly provided by the city. However, simply because an organization performs a function which has previously been performed exclusively by a municipal organization does not automatically render it exempt under Section 501(c)(6). Petitioner errs in claiming (Pet. 14) that its function is to perform services for the city, rather than its member-plumbers. Since plumbers remain liable for injuries caused by unrestored excavations, the economic burden of prolonged restoration is borne by petitioner's membership, rather than by the city or its residents.

formance of particular services for individual persons."[7] Indeed, the district court stated in *Kansas City Hay Dealers* that the term "business league" is "not defined in the act itself, nor has any judicial decision construing [it] as here used been called to my attention" (28 F. 2d at 910). Given the numerous subsequent appellate court decisions upholding the validity of the present regulations,[8] *Kansas City Hay Dealers* is of doubtful vitality.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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SEPTEMBER 1974.

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[7]The present form of the Regulation was first promulgated in 1929. See n. 5, *supra*. The prior version (Article 518 of Treasury Regulations 45) which was effective for the tax year in *Kansas City Hay Dealers* did not exclude an organization which performed services for individual persons from the definition of "business league". It defined a "business league" as "an association of persons having some common business interest, which limits its acitivities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit."

[8]See, *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 999 (Ct. Cl.); *Evanston-North Shore Board of Realtors* v. *United States*, 320 F. 2d 375 (Ct. Cl.), certiorari denied, 376 U.S. 931; *United States* v. *Oklahoma City Retailers Assn.*, 331 F. 2d 378 (C.A. 10); *Automotive Electric Assn.*,v. *Commissioner*, 168 F. 2d 366 (C.A. 6); *Apartment Operations Assn.*,v. *Commissioner*, 136 F. 2d 435 (C.A. 9); *Underwriters' Laboratories* v. *Commissioner*, 135 F. 2d 371 (C.A. 7), certiorari denied, 320 U.S. 756.